

# ING Monthly: Back from the beach, into the breach

We are back. Fully recharged, we're taking a fresh look at the global economy, reassessing previous calls and looking forward to an exciting autumn

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Source: Shutterstock

Activists pose with faces of the G7 and other world leaders as they demonstrate on the beach in the harbour near the G7 meeting taking place in St. Ives, Cornwall, England



## The European autumn could be a game-changer for the world

Covid, supply chains, inflation and some sort of normality for central banks; all these key themes could see some positive movement over the coming months. But in our latest ING Monthly, at [www.ing.com/THINK](http://www.ing.com/THINK), we want to prepare you for a marathon, not a sprint

### [Watch video](#)

We are back. Fully recharged, we're taking a fresh look at the global economy, we're reassessing previous calls and are now looking forward to an exciting autumn. In fact, the summer confirmed and accentuated the four most important themes for the global economy: the ongoing fight against Covid and its variants, supply chain frictions, inflation and central banks' long and winding road to the exit lane. The G7 leaders, who met in an English seaside resort back in June, still have a huge task in front of them. And they'll still face plenty of protests, perhaps just not quite as creative as the one we use to illustrate our latest ING Monthly.

The Delta variant has become the dominant strain and is a worry for financial markets as it could dent the economic recovery. However, assessing the impact of Delta on global growth requires a more differentiated approach. Delta is not yet slowing down the entire global economy but is an important driver of a two-speeded recovery. While most developed economies have reached a vaccination rate of around 60%, which allows governments to refrain from new lockdowns, much lower vaccination rates in emerging economies have led to a 'zero Covid' approach by many Asian governments. These differences in vaccination rates and government reactions clearly lead to diverging growth prospects. Luckily, there is one clear upside: leaving new Covid variant surprises aside, we see the global economy reaching herd immunity before next summer; be it via vaccinations or cured infections.

For developed economies and particularly the ones with a strong industrial backbone, supply chain frictions have probably become an even bigger risk to the economic outlook than Delta. Further delivery and production delays could clearly weigh on the growth path for the next 12 months. Supply chains are also a potential transmission channel for lagging growth and 'zero Covid' in Asia

to spill over to Europe and the US.

Supply chain problems not only lead to production delays but are also one of the main drivers behind the surge in inflation in both the US and the eurozone. We have written a lot about inflation since the start of the year and our bottom line is still the same: yes, the largest part of the current inflation surge can be explained by one-off factors and base effects. However, even if headline inflation drops back next year, inflation is likely to be stickier than some, particularly some central banks, currently expect. Record high producer prices, a high willingness to pass these costs onto consumers who, with a strong post-lockdown appetite for spending and some excess savings, are more than willing to accept higher prices. Also, with the lack of qualified workers, some pass-through on wages is also likely. And don't forget that one important disinflationary driver has turned into a more inflationary force: globalisation.

As higher inflation could dent consumer spending, central banks are facing a difficult choice of when or whether to taper. While tapering could undermine the economic recovery and disrupt financial markets, leaving it too late could put central banks behind the curve and trigger much stronger policy reactions in the future. It looks as if both the Federal Reserve and the European Central Bank are currently willing to allow at least some second-round effects on wages. A very cautious and very gradual taper is the result. In the US this is more likely to happen than in the eurozone, where the ECB has shifted from dovish to overly dovish during the summer months.

And while central banks are still searching for the exit, one politician who has shaped the European and global economy over the last 16 years will definitely exit. The German elections at the end of the month mark the end of Angela Merkel's four terms in office. However, the current too-close-to-call election race in Germany could lead to very long coalition negotiations and could force Merkel to stay on longer than she herself had thought.

Autumn could bring a race to the exit lane, for the pandemic, central banks and for Angela Merkel. There is clearly the risk that this will be more of a marathon than a sprint.

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## US recovery has challenges to overcome

The US economy is having to deal with a number of challenges that will weigh on growth in the near-term while keeping inflation elevated. Nonetheless,...



US President, Joe Biden, just before speaking about the US' withdrawal from Afghanistan

### Consumer caution weighs on growth

The US economy has fully regained all the output lost to the pandemic, but while prospects remain good, there are near-term headwinds that have resulted in us lowering our growth forecasts.

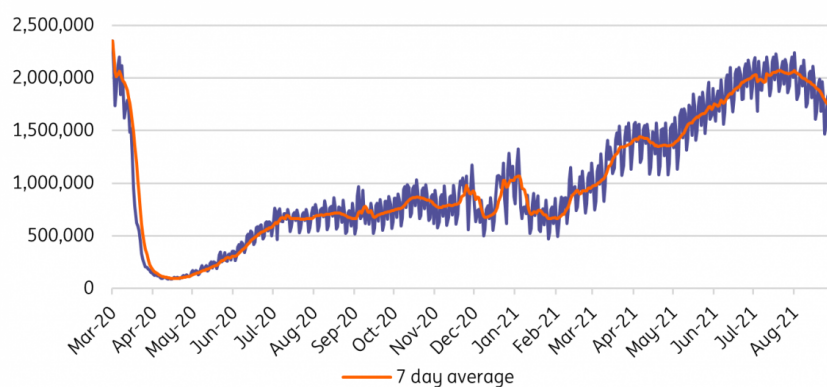
The resurgence of Covid has contributed to the seventh steepest fall of all time in the University of Michigan sentiment index. Consumer caution has translated into a reduction in the movement of people with high frequency data showing a notable softening in air passenger numbers and restaurant bookings. This suggests weakness more broadly in the travel, leisure and hospitality sectors.

Part of the decline in confidence can also be attributed to consumer anxiety over the rising cost of living with households increasingly aware of higher prices, be it food, gasoline, houses or cars. Home, car and appliance buying intentions have all dropped in response. Coming after the stimulus cheque fuelled spending surge in the second quarter, the third quarter was always going to experience slower consumer spending growth. Unfortunately, given these developments we now expect to see a small outright contraction.

The corporate sector also remains under pressure with supply chain issues and labour market shortages showing little sign of easing. This is limiting growth potential with inventory levels being run down to record levels. The construction sector is also starting to see activity moderate, but strong business investment, better net trade numbers and a positive government contribution should mean we still get a respectable third quarter GDP growth figure of around 4.5%.

As a result of our 3Q downward revisions, combined with 2Q GDP growth disappointing expectations (due to supply chain strains holding back economic activity which has led to another major run down in inventories) we have lowered our full year growth forecast to 5.9% from 6.7%.

## Daily TSA security check numbers at US airports



Source: Macrobond, ING

## 2022 to see a durable recovery

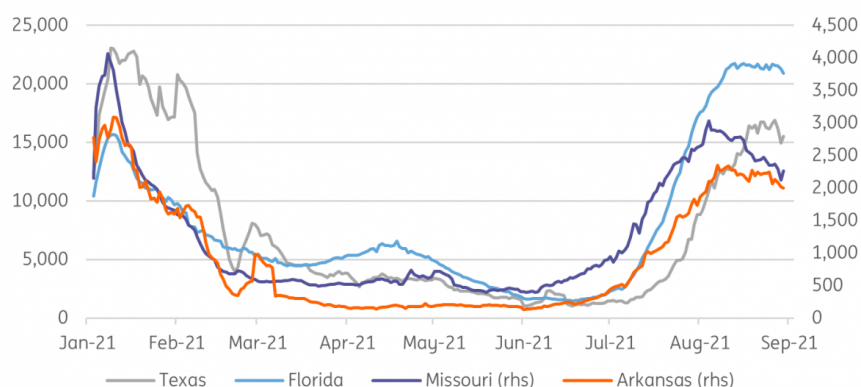
The economic disruption from Hurricane Ida could additionally knock off a couple of tenths from 3Q GDP growth, but what we expect to find is that the clean-up operation and rebuilding and replacement of buildings, equipment and cars will actually contribute positively to growth in the fourth quarter.

Moreover, there is already evidence that Covid case numbers are topping out and are actually falling in some of the “hot spots” such as Missouri and Texas, which should help sentiment to gradually recover. We are also seeing private income growth rise as the competition for workers pushes up wages while employment gains continue to be made. Corporate investment looks set to continue contributing strongly while stronger growth overseas will help exports. As such, we still expect to see full year growth of around 6% for 2021.

We assume that supply chain strains will ease in the quarters ahead and this will allow a major rebuilding of inventories next year. With the government infrastructure plan and an additional \$3.5tn of social spending set to feed into the economy, plus ongoing job creation and solid income gains, we continue to forecast growth of close to 5% for 2022.



## Covid case numbers in selected states



Source: Macrobond, ING

Covid cases - 7 day average

## QE taper is on its way

Inflation is showing little sign of easing given the supply strains within the economy. Surveys suggest companies are confident that they can pass much of their higher costs onto consumers while rising housing costs will be a factor that we think will keep headline inflation above 5% for the rest of this year and core inflation above 3.5% through to next summer.

Unsurprisingly, we are hearing more and more Federal Reserve officials suggest it is time to “dial back” on the policy stimulus and end quantitative easing asset purchases soon.

St. Louis Fed President James Bullard has been the most vocal, stating that, “It’s not clear to me that we’re really doing anything useful here” while Dallas Fed President Robert Kaplan argued that “these purchases are not well suited to the environment we’re in now”.

## Jerome Powell not fully on board

Fed Chair Jerome Powell is not convinced though. During his Jackson Hole symposium speech he merely acknowledged that it “could” be appropriate to taper this year. His comment that an “ill-timed policy move” could be “particularly harmful” suggests the resurgence of Covid is weighing heavily on his thinking.

He also wants to see the economy create more jobs. Given there are still 5.7mn fewer people in work than in February 2020, there is “much ground to cover to reach maximum employment,” according to Powell.

## US employment levels (m) - still well down on pre-pandemic highs



Source: Macrobond, ING

## On course for higher interest rates

We doubt the August jobs report will be strong enough to convince him to back a taper announcement at the 22 September FOMC meeting with the odds favouring a November decision, and purchases being reduced from December onwards. We suspect that it will be implemented proportionally between agency Mortgage-Backed Securities and Treasuries, and that it will be concluded over a six-month period.

Jerome Powell has made it clear that the decision on QE tapering is completely separate from any discussion on raising interest rates. Nonetheless, there are already 7 out of 18 FOMC members who think they will be raising interest rates next year. It would only take a couple of members to switch their views to bring the median forecast to a 2022 rate rise. Given our growth and inflation forecasts and ongoing supportive fiscal policy this is our baseline view.

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Article | 2 September 2021

## The eurozone is dealing with Delta better than most

Thanks to high vaccination rates, the eurozone economy is dealing with the Delta variant better than most, though supply chain troubles are becoming a...



European Commission President, Ursula von der Leyen, at a news conference about the Afghan crisis

### The last shall be first

Things can change. While at the beginning of this year the eurozone was a laggard in the vaccination campaign – something we did not fail to point out repeatedly – the monetary union has now become one of the frontrunners, comfortably beating the US in terms of the number of people fully vaccinated. This explains why the Delta variant is causing less havoc in Europe, at least for the time being.

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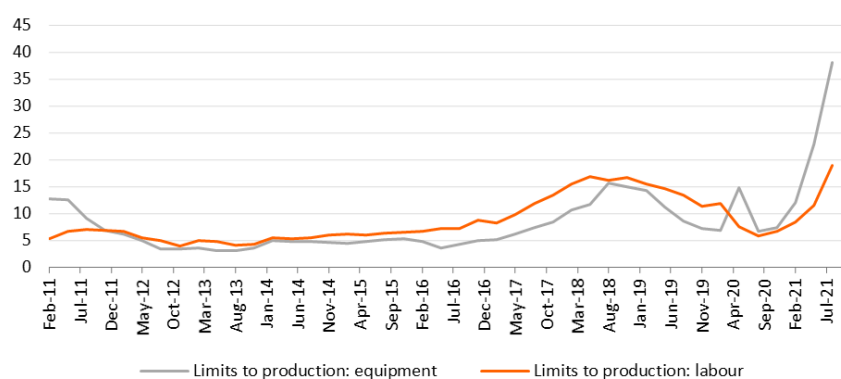
*We're not completely out of the woods*

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That doesn't mean we are completely out of the woods. Indirectly, growth in Europe could also be affected by a temporary deceleration in the rest of the world. On top of that, global supply chain

distortions have now clearly reached a point where they are starting to slow growth, especially in countries with an important manufacturing sector, such as Germany. Indeed, in manufacturing, the net percentage of companies reporting constraints on production because of a lack of inputs has reached the highest level since the survey started more than 35 years ago. At the same time, a growing labour shortage seems to be emerging, further impacting the supply side of the economy.

## Industry survey shows increasing production constraints



Source: Refinitiv Datastream

## Strong summer

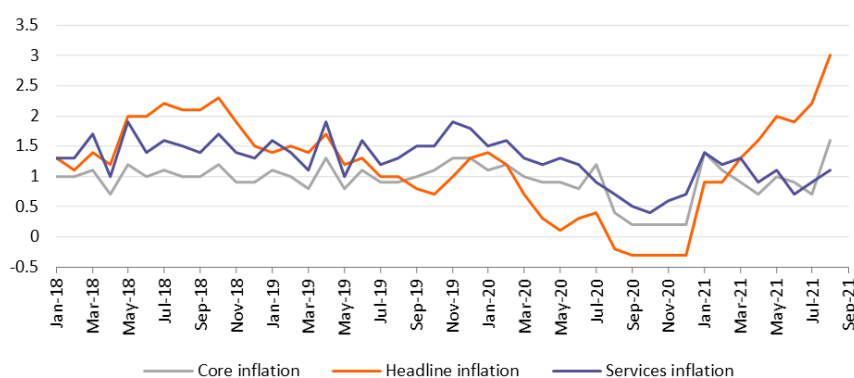
To be sure, growth remains very strong. The eurozone PMI was close to a 15-year high in August, with hiring intentions and new orders still buoyant. We are now less convinced that the ending of the temporary unemployment schemes will have a big upward impact on unemployment figures, as job openings are growing rapidly. The healthy labour market is likely to unleash some of the excess savings accumulated throughout the pandemic. In that regard, we think that 3Q growth might match the surprisingly strong 2Q, before gradually starting to decelerate. On the back of the strong second quarter, we have revised our growth forecast for 2021 upwards to 4.9% and for 2022 to 4.1%.

## Inflation noise

With a stronger than expected jump to 3% in August, eurozone headline inflation is now at the highest level in 10 years. Energy prices are one of the main culprits, an impact that is likely to peter out over the course of 2022. Core inflation also climbed to 1.6% but here, some statistical noise (delayed summer sales period in 2020 in some countries, creating an adverse base effect) overstated the true increase in price pressures. The fact that services inflation, albeit rising, came out at 1.1%, shows that the underlying upward trend in inflation remains subdued for now.

That said, in the wake of increasing labour market tightness and high current inflation figures, it is not hard to imagine trade unions demanding hefty wage increases. And indeed, in Germany the era of wage moderation seems to be coming to an end with employers likely to be forced to go some way to meeting trade unions' demands in the forthcoming wage round. The bottom line is that while some of the current inflation overshoot is likely to be temporary, we still believe that the underlying inflation trend is now slightly upwards. We therefore have higher inflation forecasts than the ECB, namely 1.7% next year and 1.6% in 2023. Admittedly, these figures are still below the Bank's new symmetric inflation target of 2%.

## High, but distorted inflation figures



Source: Refinitiv Datastream

## Still dovish ECB

If anything, the ECB seems to have become slightly more dovish, with the governing council now expecting key interest rates to remain at their present or lower levels until it sees inflation reaching 2% well ahead of the end of its projection horizon and durably for the rest of the projection horizon. At the same time, the ECB is still more worried about the inflation rate being too low in the medium term rather than too high. This doesn't mean that there won't be any tapering of bond purchases. Though the ECB doesn't seem to be in a hurry to give more guidance on its bond purchase programmes (this might have to wait until December), we continue to believe that the Pandemic Emergency Purchase Programme will end in March next year. At the same time, the Asset Purchase Programme will probably be increased from €20 to €60bn a month in order to have a more gradual phasing out of quantitative easing. As for interest rate policy, we now think that the ECB is unlikely to increase interest rates before 2024.

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## China's policies hit the jobs market

Since June, the Chinese government has demonstrated a unique economic concept that blends planned and market economies. We're not worried about the...



Chinese President, Xi Jinping, on a recent tour of the north of the country

### A planned economy aiming for higher labour productivity and sustainable technological advancement

The first reform this year involved the deleveraging of real estate property developers. The debt ratios are now lower, but not enough for a pause in the reforms, which are therefore still continuing. This has affected growth in the construction sector, the wages of real estate agents and also their career prospects. In addition, putting a cap on the rise in home prices seems to be a long-lasting policy.

The second reform was a batch of policies that targeted the whole technology sector: from imposing regulations on fintechs to improving data privacy in smartphone apps. The objective of these regulations is to increase the sustainability of the industry and to protect consumers.

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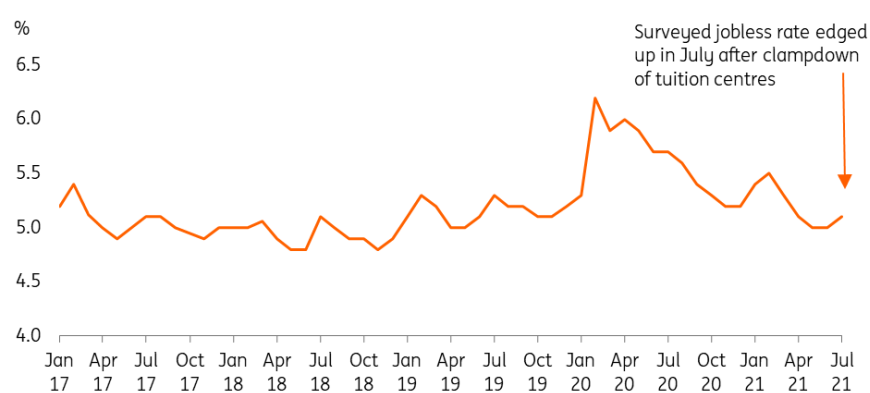
*The central government is aiming for a high-quality workforce*

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Then came a third round of reform which closed down education centres, banned 996 working hours (9am to 9pm for six days a week, which was normal for the technology industry) and limited the time youngsters spend on online games. The closing of education centres is a response to complaints about the high cost of raising a child, which also seems to be a big hurdle to implementing the third child policy. Limiting long working hours could also help facilitate the third child policy. The cap on time spent on online games aims to increase the productivity of the workforce. The government does not want the future workforce to be addicted to various forms of entertainment.

The central government is aiming for a high-quality workforce and a high quality of life for the people in the long term. But there is a short term cost as these industries need to figure out how to adapt to these policies, and in the process, many people could find themselves out of work.

## China surveyed jobless rate



Source: CEIC, ING

## Some people are worried about their jobs; we're concerned about China's spending growth

If more workers consider their job security to be shaky or have already been made jobless (e.g. those working in tuition centres), sentiment around consumption is bound to be weaker. We can't take this lightly as China's consumption market is big.

This adds more pressure to the economy since external demand is also uncertain as a result of the Delta variant of Covid, chip shortages and interrupted supply chains.

It seems that no one wants to talk about "[dual circulation](#)" anymore, since these new policies have been introduced in one big lump. Both external and internal growth are weaker than at the beginning of the year.

As such, there should be more plans coming from the government to support overall economic growth, such as speeding up delayed infrastructure projects and cutting the reserve requirement ratio again in October to lower market lending rates so that local governments can more easily raise funds for infrastructure projects.

Combining the above, our current GDP forecast for the second half of 2021 has been lowered to 4.8% year-on-year. Our USD/CNY forecast for the end of 2021 is 6.70 as China's monetary policy is going to ease against the Federal Reserve's backdrop of tapering.

## Delta a dent but not a disaster for the UK economy

The UK's third wave of Covid-19 has stalled the recovery but hasn't so far tempered consumer confidence dramatically. The fourth quarter will be a...



The UK Prime Minister, Boris Johnson, at a visit to the British Foreign Office last week

### Delta has paused the recovery - but it's not been a disaster

As the summer slowly ends, there's little doubt that the UK recovery has stalled since our last monthly economic update in July. The spread of the Delta variant, and the high rates of self-isolation that entailed until the rules were changed mid-August, only served to amplify the staff shortages being reported in various corners of the UK jobs market. PMIs have fallen off recent highs.

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*The UK economy has arguably weathered Covid-19's third wave slightly better than we'd feared*

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But when it comes to consumer spending, the economy has arguably weathered Covid-19's third



wave slightly better than we'd feared. The risk was that the renewed spread of the virus would seriously temper the newly-fostered confidence in socialising and leaving home. So far though, that hasn't really happened. Social spending on things like hotels and restaurants hit a fresh post-virus high in August, while a weekly [ONS survey](#) has registered only a small decline in willingness to leave home (though admittedly this is more pronounced among older age groups).

Spending on goods has slipped, though we think this is more likely down to a rebalancing towards newly-reopened services, and also marks a correction after the initial hype when shops opened up in April.

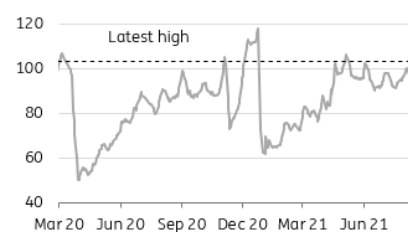
For now, we're comfortable with our 1.5% growth projection for the current quarter, though this was already low relative to other forecasters.

## The UK economic dashboard

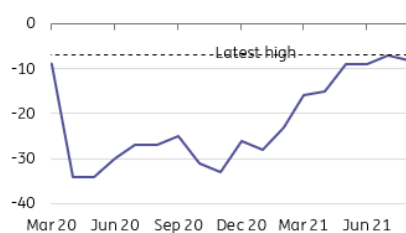
Google Mobility\* (pre-virus=0)



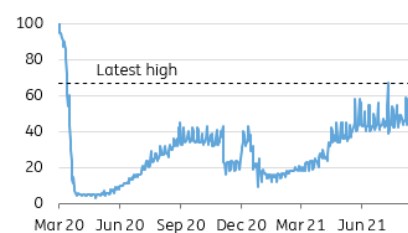
Aggregate card spending (CHAPS, pre-virus=100)



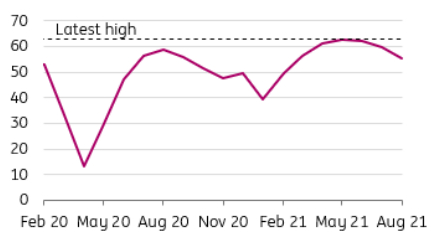
GfK Consumer Confidence (pre-virus = -9)



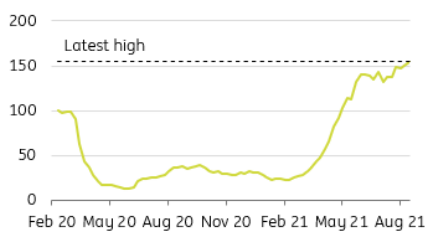
London Underground usage (pre-virus = 100%)



Services PMI (pre-virus = 53.9)



Catering/hospitality job adverts (pre-virus = 100)



Source: Macrobond, ING

## The fourth quarter is more of a question mark

The fourth quarter is more of an unknown. The positive news from recent weeks is that hospitalisations have stayed comparatively low, suggesting that vaccines will help avoid a lockdown this winter. The counterpoint is that the number of hospital beds occupied are considerably higher than this time last year. With flu expected to also take off, negative headlines about NHS pressure may translate into greater consumer caution than we're currently seeing.

Interestingly and despite the reasonably solid spending figures over recent weeks, consumers haven't been running down the excess savings built up through successive lockdowns. And if it

hasn't happened so far, then it's hard to see a 'big bang' moment where consumers begin to splash the cash this winter. Unemployment is also likely to drift back above 5% as the furlough scheme comes to an end.

In short, further gains in growth will be harder to achieve than during the bumper second quarter, when the economy grew by almost 5%. We expect GDP to recover to pre-virus levels early next year.

## Inflation set to peak close to 4%

The summer has also heralded higher inflation forecasts. We now expect inflation to come close to 4% towards the end of this year and stay there into early 2022. Partly that's because of supply chain issues, and the latest disruption in Asia points to renewed price pressure for Christmas shoppers. Higher wholesale gas prices have also led the regulator to announce a 12% hike in the energy price cap in October.

But the inflation picture should cool by this time next year. That suggests that talk of a rate hike in the first half of 2022 is a little premature, though we have brought forward our call to the fourth quarter of next year. Importantly, the Bank of England has said it will stop reinvestment proceeds from maturing gilts when rates hit 0.5%, and we expect that to happen in the second half of 2023. Policymakers have hinted they could actively sell gilts back into the market when Bank rate hits 1%, though in practice, that milestone feels very distant indeed.

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## No one-size-fits-all narrative for Asia

There is a broad spectrum of performance and policy reaction in Asia, though if you have to pick a central theme, it is still the influence of Covid-19



South Korea's President, Moon Jae-in, governs a country that is outperforming others in Asia as far as vaccinations are concerned

### GDP forecasts have been raised, then cut

Our Asia GDP forecasts this year have whipped around. Like many forecasters, we underestimated the bounce in the first quarter of the year, which most countries participated in. Japan missed out, implementing "states of emergency" at this time - possibly to try to get ahead of the virus in advance of the Tokyo Olympics. That didn't go to plan. The current daily tally is well over 20,000, by far the highest yet.

For most of the rest of the region, a promising start has given way to a slide back into lockdowns or other restrictions on movement. New pandemic waves have struck, thanks mainly to the Delta variant. While possibly no deadlier than some of the other variants, Delta's greater transmissibility has shown the weaknesses in Covid defences built around border closures and test/trace/isolation. With no such thing as a 100% virus-proof seal, Delta has so far always found a way around firewalls. And once in, has almost always spread rapidly.

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*Learning to live with Covid is a luxury that in Asia, only Singapore*

*seems in a position to embrace*

For those economies in Asia which have made solid progress with vaccinations (there are only two), this has not been a massive issue. Learning to live with Covid is a luxury that in Asia, only Singapore seems in a position to be able to embrace, though the adjustment to an endemic disease is a slow and cautious one.

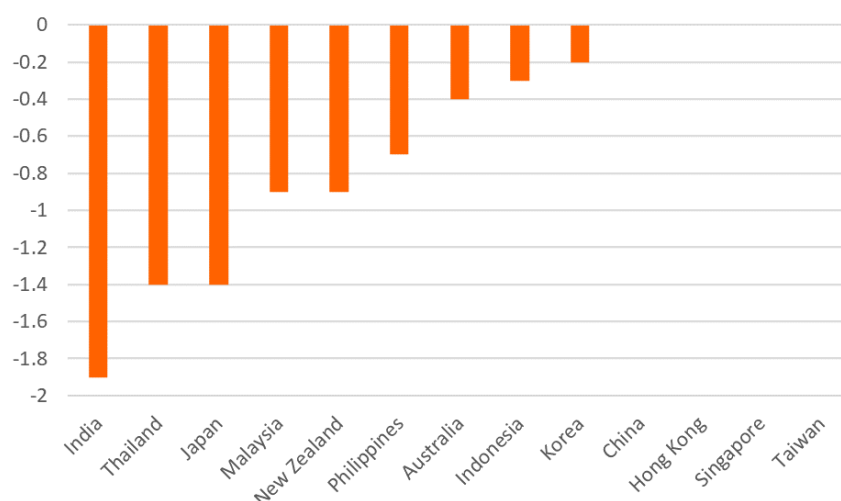
Outside China, which has its own unique approach to the pandemic, Korea is towards the higher end of the Asia pack in terms of vaccination, though it remains mid-ranking in global terms. The Bank of Korea (BoK) has nonetheless managed to address surging household debt and ballooning property prices by being the first economy in Asia to hike rates. The BoK raised its 7-day repo-rate by 25bp to 0.75% on 26 August.

In doing so, the BoK beat the Reserve Bank of New Zealand to this honour. The RBNZ had also flagged a hike some time ago, but it felt compelled to delay an anticipated rise in the cash rate as its Covid strategy unravelled against a very weak vaccination backdrop. The Reserve Bank of Australia (RBA) is doing its best to stay dovish relative to the US Federal Reserve, so Australia's own relatively slow vaccination progress is less of an impediment to the RBA's policy intentions. Instead, it plays nicely into the RBA's narrative of "nothing for ages" in terms of monetary policy, despite some solid progress in the labour market and rising inflation.

We've also seen some hits to China's growth stemming from the closure of ports and airports due to Covid outbreaks, though this is likely to be temporary, and we haven't had to revise our full-year 2021 forecasts, mainly as earlier strength is likely to offset second-half weakness (see also China section).

## Revisions of 2021 GDP forecasts

% from peak forecast



Source: ING

## South and South East Asia look bad

Singapore aside, our forecasts have been trimmed the most - and may still need further topiary - in South and South-East Asia. Very low vaccination rates and reliance on a stock of arguably less-effective vaccines (no brand names for obvious reasons) coupled with porous, regional, creeping, incremental lockdowns has all contributed to a feeble defence against the Delta variant and new damaging waves for these countries.

Tracking what is going on is difficult since we don't have any faith in the daily cases reported from many of these countries. These seem mainly to be a function of (often inadequate) testing rates. The daily death tally, however, may offer more insight, as it is less prone (though not immune) to underestimation, though it has the drawback of being a lagging indicator. That means it is probably a better indicator of "scale" than it is of "direction".

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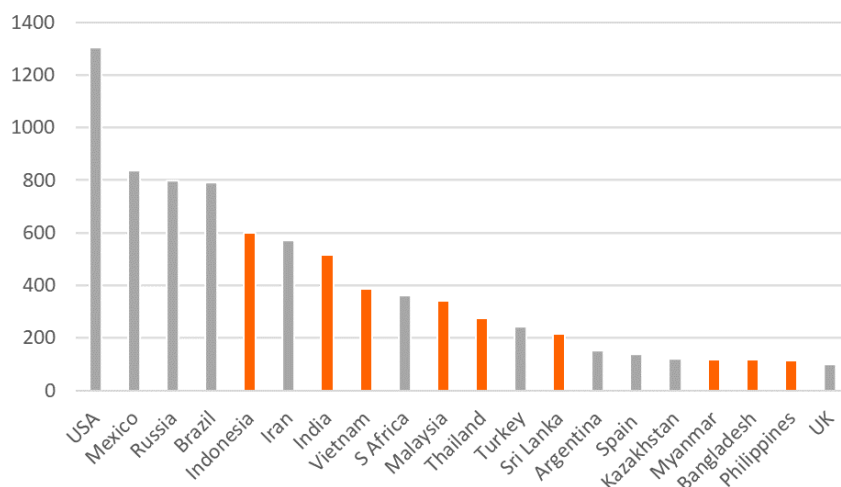
*Asian countries still feature too prominently in the global top-20 for deaths*

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Nonetheless, Asian countries (shaded orange) still feature too prominently in the global top-20 for deaths. Indonesia has been one of the worst affected in the region during the latest wave. But adjusted for population size, the death counts in Malaysia and Thailand are not much less discouraging.

The Philippines has done slightly better, but not well enough to escape the attention of one of the rating agencies. Fitch Ratings has revised its outlook for the Philippines long-term foreign currency debt to negative from stable, citing "scarring" effects on the economy from the pandemic - or what economists might call "hysteresis" (permanent effects on potential output from temporary shocks). We think that any actual rating downgrade may not happen until next year, but it raises question marks for other sovereigns on the borderline of investment-grade, such as Indonesia - you can read more about that [here](#) - and only solid vaccination progress is likely to improve that outlook.

## Daily Deaths from Covid-19



Source: Worldometer

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## There's more to FX than EUR/USD

FX markets are ending the summer as they began, caught between the cross currents of monetary policy normalisation and renewed lockdowns. Abundant...



The RBNZ confirmed it would have hiked on 18 August were it not for Prime Minister, Jacinda Ardern, announcing a new national lockdown on the same day

### A stop-start approach to policy normalisation and FX

The best example of the balancing act between monetary policy normalisation and lockdowns came last month when the Reserve Bank of New Zealand defied market expectations of tightening and left its policy rate unchanged. This occurred despite the RBNZ raising its own projections for the interest rate cycle.

Barely a week later, the RBNZ confirmed that it would have hiked on 18 August (perhaps by 50bp!) were it not for Prime Minister Jacinda Ardern announcing a new national lockdown on that same very day. NZD/USD fell 3% in mid-August and has since recouped all of those losses.

Beyond those cross-currents playing out in a single country, we have seen these themes drive regional FX trends this summer. Asian FX, in general, has fared the worst as low vaccination rates have exposed South East Asia and then most recently Korea to new waves of the virus.

With higher vaccination rates, European FX has actually performed better during this period and generated outright gains for the likes of the Czech koruna and the Hungarian forint as local central banks have pushed ahead with tightening cycles.

## Local stories can play out if Fed tapering is benign

We prefer these local stories to dominate into year-end. Those G10 central banks confident enough to tighten rates - New Zealand, Norway, and into 2022 Canada and the UK - should see their currencies outperform. While those committed to deeply reflationary policies, such as the eurozone, Switzerland, and Japan, should see relative underperformance.

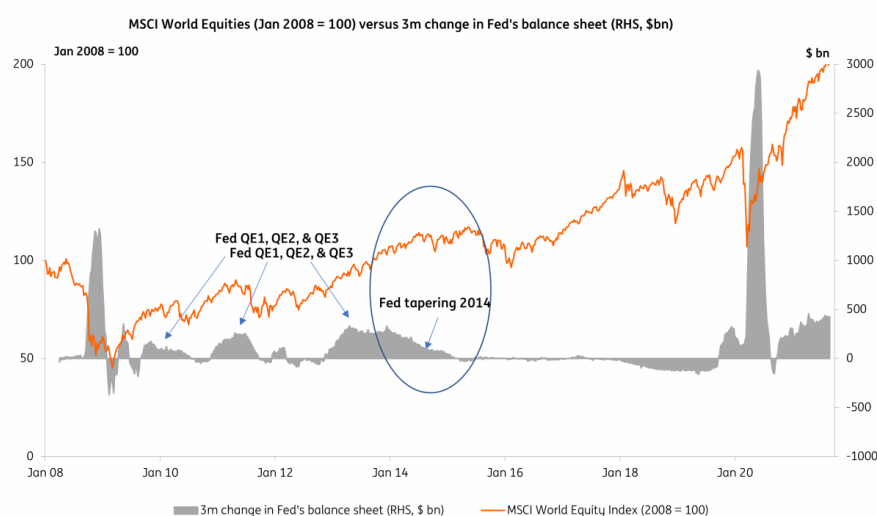
### *FX trends assume Fed policy remains a benign market influence*

In the emerging markets space, this theme extends to Brazil, Russia, the Czech Republic, and Hungary outperforming and now the Chinese renminbi underperforming based on Iris Pang's view.

FX trends based on this policy divergence assume that the external environment – Fed policy – remains a benign market influence. The Fed has developed a good track record here and we would assume that tapering is communicated and performed in an orderly manner such that it need not trigger a dramatic repricing in bonds and equities.

This was the experience during the last Fed tapering in 2014/15. Mismanagement by the Fed here would deliver a stronger dollar and a sell-off in the high-beta FX pairs.

## Fed tapering needs to be orderly



Source: Fed, ING

## EUR/USD: Waiting for the spark

FX options markets can provide a good gauge of sentiment – or at least expected volatility. Currently, prices for one year EUR/USD options are continuing to decline and appear to be heading to their pre-pandemic levels of 5.00%. This points to continued calm in a currency pair dominated by abundant liquidity on both sides of the Atlantic.

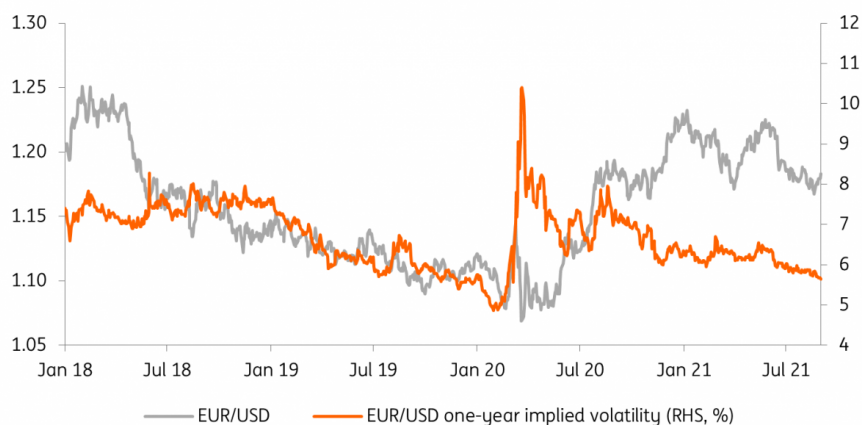
1.17-1.20 may be the EUR/USD range into year-end, with the pair ending towards the top of the range given seasonal dollar weakness. We would expect a broader dollar rally to emerge through



1H2022 as the market grows increasingly confident of the first Fed tightening later in the year.

Beyond the usual event risks of central bank meetings, it is also worth noting that the European political calendar is getting noticed. The FX options market prices 30% more volatility than normal around the German election on 26 September. But the French presidential election next April is seen as a much bigger deal for FX markets. Volatility around the run-off vote on 24 April is priced at four times a normal day.

## EUR/USD option prices continue to correct lower



Source: Refinitiv, ING

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Article | 2 September 2021

## Rates: System risk is on the floor. Here's why it matters

How markets feel about risk is uber-important but risk perception is minimal right now. One measure of this is the rate banks need to pay to entice...



Fed Chairman, Jerome Powell

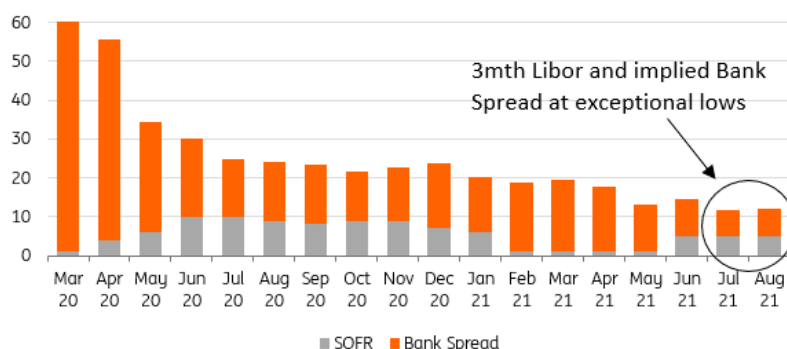
### The perception of risk is being significantly muted by liquidity excess

A key driver of global rates, credit and foreign exchange emanates from liquidity conditions in the US. Or to put it better, there's a remarkable excess of liquidity. Since the outbreak of Covid in early 2020 the Federal Reserve has bought a cumulative USD4trn of bonds. It's a massive sum. It equates to almost 20% of US GDP. The size of the Fed's bond-buying has, in a roundabout way, financed much of the crisis in the US. It is also leaving large chunks of liquidity flushing around the system. In fact, in excess of USD1trn is being posted back at the Fed on an overnight basis by players that are finding it tough to beat the 5bp on offer at the Fed's reverse repo window.

*If banks can print virtually for free, then system risk is indeed ultra-low*

So why is this important from a global perspective? It is acting to dampen the perception of risk. We see this on a number of fronts. We see it filtering into remarkably tight credit spreads, and seeping into super-buoyant equity markets. This is not all coming from the Fed's bond-buying programme, but at the margin; some of it gets channelled there. Equally important is the effect it's having on the cost of funding for banks, which is on the floor. This is the ultimate measure of risk, in fact, measuring system risk. If banks can print virtually for free (and they can, at just a smidgen above the risk-free rate), then system risk is indeed ultra-low.

### USD 3mth Libor = Risk Free Rate + Bank Spread (which is exceptionally low)



Source: Macrobond, ING estimates

### This remains a supportive factor for risk assets of all guises

*The 3mth USD Libor rate at sub-12bp currently is a measure of this. At just 7bp above SOFR, it's a steal.*

The 3mth USD Libor rate at sub-12bp currently is a measure of this. It's a reflection of where banks can fund themselves. At just 7bp above SOFR, it's a steal for banks. More importantly, that gets reflected in funding rates for all types of products linked to USD Libor. It in turn reflects really tight credit spread generally. And for the global system, it means that the global financial system is not worried, at all. This in turn contains the ability for the US dollar to appreciate out of control. It is also a key containment factor, as it allows emerging markets to hang in there too, bolstered by cheap liquidity and low perception of risk.

## A taper would begin to unravel a lot of this, raising the perception of risk

There is a means to at least muting this effect, and that would be through a taper of bond buying, and ultimately a stop. Even then that USD4trn of bond-buying remains in place. For that to change the Fed would have to sell bonds back to the marketplace, or let them roll off without reinvesting. These are options for the future, ones that can both take liquidity out of the money market and place upward pressure on longer market rates. When we get to that point, the perception of risk should rise too, affecting credit spreads and pressuring emerging markets.

Chair Powell has much more than a domestic agenda on his mind as he addresses the taper in the weeks ahead. And that's partly a reason for caution. The unravelling of a good thing can have many unintended consequences. Some dither on the taper is understandable.

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Article | 2 September 2021

## No quick fixes for supply chain frictions

New lockdowns in Asia, including that of another major Chinese port, mean more disruption to supply chains. Each new setback is proving harder to recover...

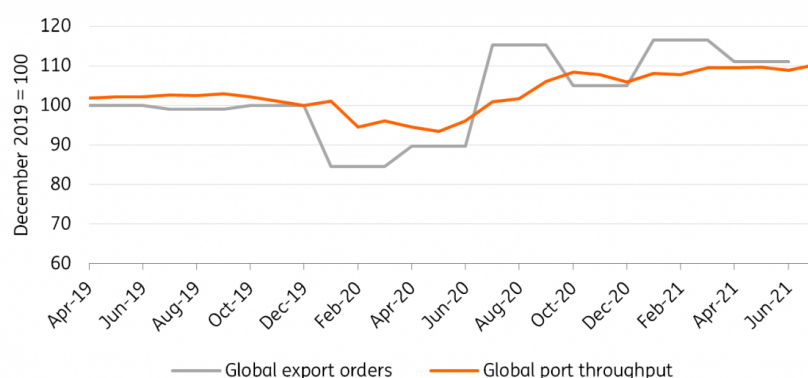


Restrictions in Chinese ports are causing global supply disruptions. President Xi of China is pictured at Ningbo-Zhoushan port last year

During the summer, demand for traded goods has remained strong as the US and eurozone economies have seen activity increase. But a gap has opened up between global demand and the capacity of ocean freight to deliver. New lockdowns to combat the spread of the Delta variant of the virus are causing fresh problems for supply chains that are increasingly visible in low stock levels, rising lead times, and materials shortages.

## Ocean freight capacity is struggling to meet demand

Global port throughput and new export orders



Source: RWI/ISL, World Trade Organisation, ING calculations

## Lockdowns affecting key hubs of global supply

Local lockdowns are having global consequences by affecting hubs of global supply and ocean freight capacity. Factory closures in Vietnam in recent weeks have disrupted the supply chains of major clothing, footwear and electronics brands, as well as Japanese car manufacturers. And the closure of China's Ningbo-Zhoushan port in mid-August follows the lockdown at another major Chinese port, Yantian, in March, which saw the port operating below its full capacity for several weeks.

Each setback causes a fresh set of problems for supply chains, most obviously through the delay of key inputs, but also the displacement of containers, which in turn makes it even harder to catch up again. As a result of congestion in ports, less than half of ships globally have been arriving at their scheduled arrival times through 2021, and delays for late ships are consistently adding more than a week to delivery times.

## Shipping capacity improves, but no quick fixes

Capacity on major shipping routes between Asia, Europe and the US has recovered to levels before the major lockdowns in 2020, but this capacity is being tightly managed by shipping companies in their alliances. Blank sailings (container ship journeys being scheduled, but then cancelled) have caused around 10% of scheduled capacity to be cut at short notice through the first half of 2021. On current plans, cancelled sailings will fall to around 4% in the second half of the year.

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*There are no quick fixes in sight*

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The cancellations are partly shipping companies' response to delays, and therefore likely to remain a source of uncertainty for exporters and importers during the pandemic recovery, and even as capacity is expanded through the building of new container ships. In the meantime, each new disruption to production and ocean freight capacity will continue to see supply chain problems build up quickly and then linger, with no quick fixes in sight.

## Frictions won't be forgotten

Frictions are adding to other trade barriers which have arisen during the pandemic. Emergency measures to secure supplies of medical goods and food, as well as the subsidies to domestic industry from stimulus programmes, have made it more difficult to export to foreign markets - something that had already been becoming more difficult before the pandemic, partly thanks to the US-China trade war. And there is no appetite to bring trade barriers back down. Policy efforts in China, the EU and the US seem instead to be focusing on reshoring in key sectors, with a new push to develop domestic capabilities, especially in technology, and create a degree of independence in the supply of essential medicines and technology goods.

If policies, along with the frictions that have built up in supply chains, lower the relative costs of producing at home, this may tilt the balance for some supply chains to be brought home. Any changes are likely to be slow, as reshoring is difficult and costly. However, the ongoing disruptions to supply during the pandemic have brought the risks of using global supply chains into focus. The sudden and persistent rise in frictions during the pandemic won't be forgotten as firms decide whether to adjust supply chains.

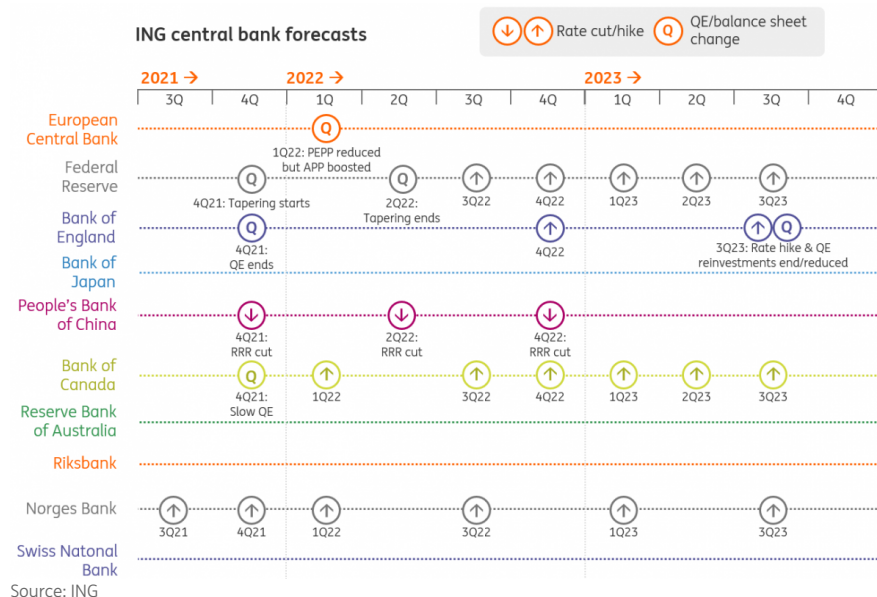
# ING's outlook for central banks

Our economists look at the places where monetary policy is likely to be tightened first over the next few years



PBoC governor, Yi Gang, with the Fed's Jerome Powell in 2019

## The race to hike interest rates and end QE





## Federal Reserve

More and more Federal Reserve officials believe that it is time to “dial back” on the policy stimulus. Fed Chair Jerome Powell has been more cautious, but he too now recognises it “could” be appropriate to taper the \$120bn per month of quantitative easing this year. His wariness stems from the resurgence of Covid and the sense that an “ill-timed policy move” could be “particularly harmful”.

Moreover, while “substantial further progress” has been made with regards to inflation, there are still 5.7mn fewer people in work than in February 2020, meaning there is still “much ground to cover to reach maximum employment,” according to Powell.

Consequently, a huge gain in August nonfarm payrolls will be needed for him and other Fed governors to support a September taper announcement. It looks as though a November agreement with a December starting point is the most likely path ahead.

In terms of rates we remain optimistic on growth, but supply chain disruptions and labour market shortages may not ease as quickly the Fed anticipates. We see inflation staying higher for longer, and with additional fiscal spending hitting the economy we expect the Fed to start hiking interest rates in the latter part of 2022.

## European Central Bank

Over the summer, the ECB has clearly become more dovish with its new monetary policy strategy and the clear intention of bringing inflation expectations sustainably back to 2%. This means that the ECB will continue its benign stance on inflation and keep everything unchanged. Even an end to the front-loading of asset purchases looks unlikely as it would de facto mean earlier tapering in the eurozone than in the US.

We expect a first announcement of asset purchase reductions at the end of this year. This will mean a rotation out of the Pandemic Emergency Purchase Programme into the Asset Purchase Programme and only a very gradual reduction of total purchases. Consequently, the ECB will not be in a hurry to completely unwind QE.

With the new dovishness, a first rate hike should not be expected before 2024.

## People's Bank of China

The PBoC is expected to continue cutting the reserve requirement ratio (RRR) in 4Q21, following a cut in July, to ease the rising pressure from credit costs. The economy is currently facing challenges from reforms in the real estate, technology and education sectors, as well as chip shortages that have affected production. Occasional localised Covid-19 lockdowns have also affected air and marine freight operations.

The RRR cut has been effective in lowering bank lending rates and bond yields. Further easing from monetary policies will be needed given the risks stated above are not going away for the rest of 2021. The anticipated RRR cut can help to put further downward pressure on market interest rates. It is therefore unlikely that the PBoC will need to cut policy interest rates unless economic growth were to slow excessively, which is not our base case scenario.

## Bank of England

While the Bank of England doesn't explicitly tell us when the first rate rise will come, its latest forecasts effectively endorsed market expectations from late July. At that point, investors were pricing the first (partial) rate rise in mid-2022 with another 25bp move around a year later.

In practice, that's unlikely to be too wide of the mark, but we are a little more cautious than the BoE on a few key parts of the outlook. We think inflation is likely to fall more quickly back to target next year, and we disagree with the Bank's prediction that there will be no rise in unemployment when the furlough scheme ends this month.

We're now pencilling in the first rate rise in the final quarter of 2022, with another in the second half of 2023. The Bank has signalled this latter move will be accompanied by the end of reinvestments of its pool of government bonds, which were accumulated under successive rounds of QE. This 'quantitative tightening' process will be a first for the BoE which, unlike the Fed, didn't shrink its balance sheet in the post-crisis years.

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Report | 2 September 2021

# ING Monthly: Back from the beach, into the breach

Covid, supply chains, inflation and some sort of normality for central banks. These remain the four key challenges for global leaders. The European autumn...



Source: Shutterstock

Activists pose with faces of the G7 and other world leaders as they demonstrate on the beach in the harbour near the G7 meeting taking place in St. Ives, Cornwall, England

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